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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-12

CONTINENTAL OIL COMPANY, ET AL.,
Appellants,

v.

GOVERNOR OF MARYLAND, ET AL.,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF MARYLAND

BRIEF OF APPELLANTS

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ON APPEAL FROM THE COURT OF APPEALS OF MARYLAND

BRIEF OF APPELLANTS

OPINIONS BELOW

The opinion of the Court of Appeals of Maryland, filed on February 18, 1977, and captioned below as *Governor of the State of Maryland, et al. v. Exxon Corporation, et al.*, is reported at 279 Md. 410 (1977) and also at 370 A.2d 1102. The supplemental opinion of the court of appeals denying motions for reconsideration and for a stay of mandate is reported at 279 Md. 456 and also at 372 A.2d 237. The opinions of the Circuit Court for Anne Arundel County, Maryland are not officially reported. The opinions of the court of appeals

and the circuit court are printed in the Joint Appendix filed with Appellants' Jurisdictional Statements at la-134a.[1]

JURISDICTION

Appellants, Continental Oil Company and its subsidiary, Kayo Oil Company, appeal from the judgment of the Court of Appeals of Maryland holding that a Maryland statute does not violate the federal constitution. The opinion of the highest court of the State of Maryland specifically rejecting appellants' constitutional challenges to certain provisions of the statute was filed on February 8, 1977. Appellants' motions for reconsideration and for a stay of mandate were denied in a supplemental opinion of the Maryland court filed on April 13, 1977.

Notices of appeal to the Supreme Court of the United States were filed in the circuit court and court of appeals on June 27, 1977.[2] This appeal was docketed with the Court on July 1, 1977, and probable jurisdiction was noted on October 3, 1977.[3] The Supreme Court of the United States has jurisdiction to review the final judgment of the Court of Appeals of Maryland by direct appeal pursuant to 28 U.S.C. § 1257 (2) (1970).

[1] References herein to the Joint Appendix filed with the Jurisdictional Statements are cited as, e.g. J. App. at . . .; references to the Appendix filed herewith are cited as, e.g. A . . .

[2] Continental's and Kayo's notices of appeal are printed at J. App. at 139a.

[3] The Court also noted probable jurisdiction in and consolidated the separately filed appeals of Exxon Corporation and Phillips Petroleum Company (No. 77-10), Shell Oil Company (No. 77-11), Gulf Oil Company (No. 77-47) and Ashland Oil Company, Commonwealth Oil Refining Company, Inc. and Petroleum Marketing Corporation (No. 77-64).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Constitutional Provisions

U.S. Const., Article I, Section 8, Clause 3 — "The Congress shall have Power . . . To regulate Commerce with Foreign Nations and among the several States, and with the Indian Tribes."

U.S. Const., Amendment XIV — "[N]or shall any State deprive any person of . . . property without due process of law; . . ."

Statutes

The provision of the Maryland statute challenged in this appeal is paragraph C of Chapter 854 of the Laws of Maryland, 1974, as amended by Chapter 608 of the Laws of Maryland, 1975,[4] codified as Md. Ann. Code art. 56, § 157E(c), Vol. 5 B at 43 (1976 Cum. Supp.). Paragraph C provides (1975 amendments in italics):

> (c) After July 1, 1975, no producer or refiner of petroleum products shall operate a major brand, secondary brand, or unbranded service station in the State of Maryland with company personnel, a subsidiary company, commissioned agent, *or under a contract with any person, firm, or corporation managing a service station on a fee arrangement with the producer or refiner. The station must be operated by a retail service station dealer.*

QUESTIONS PRESENTED

1. Whether paragraph C of the Act, which prohibits all producers and refiners of petroleum products from continuing to operate retail service stations in the State of Maryland and requires that they divest themselves of existing company-operated stations, is unconstitutional because it is an improper exercise of the State's police

[4] Chapter 854 (1974 Md. Laws) and Chapter 608 (1975 Md. Laws) are hereinafter collectively referred to as "the Act."

power and constitutes a deprivation of property without due process of law.

2. Whether paragraph C of the Act violates the commerce clause because it discriminates against and unduly burdens interstate commerce.

INTRODUCTION

On May 31, 1974, the Act was signed into law by the Governor of the State of Maryland, effective July 1, 1974. J. App. at 3a. It contains five provisions which affect the retail marketing of petroleum products in Maryland.[5] Paragraph C of the Act prohibits all producers and/or refiners from continuing to operate their existing Maryland company-operated retail service stations after July 1, 1975. Paragraph B of the Act prohibits producers and/or refiners from opening new company-operated stations.[6]

In their bill of complaint filed in the Circuit Court for Anne Arundel County, Maryland, Continental and Kayo challenged the constitutional validity of paragraphs B and C of the Maryland Act. They contended that both provisions were an invalid exercise of the State's police power in violation of the due process clause of the fourteenth amendment and the commerce clause of the United States Constitution. Continental and Kayo did not challenge the validity of the other provisions of the Act which regulate marketing practices between producers, refiners and wholesalers and

[5] The Act in its entirety is set forth by the Maryland court at J. App. at 1a-2a.

[6] Other provisions of the Act provide for uniform price assistance programs to all retail service station dealers, a uniformly equitable system of product allocation during periods of shortages, and for the adoption of rules and regulations by the Comptroller of the State of Maryland for temporary company-operation of facilities in certain instances.

their dealers because they do not market petroleum products at retail in Maryland through service stations dealers.

Continental and Kayo support the constitutional challenge to paragraph B urged by other appellants in these consolidated appeals. However, since they market exclusively at retail in Maryland through company-operated stations and do not market through independent dealers, they focus their constitutional challenge herein on paragraph C. That provision, if upheld, imposes drastic and immediate consequences upon Continental's and Kayo's retail marketing operations in Maryland. It will require Continental and Kayo to divest all of their existing stations and compel them to cease all retail marketing operations in that state.

STATEMENT OF THE CASE

A. *The Proceedings Below*

In addition to the action filed by Continental and Kayo in the circuit court, similar actions for declaratory and injunctive relief were filed by seven other producers and/or refiners of petroleum products.[7] Exxon, Shell, Gulf and Phillips challenged the validity of all provisions of the Act because, as fully integrated oil companies, they market their petroleum products at retail in Maryland both through dealers and company operated stations. Ashland[8] and P.M.C.[9], like Kayo,

[7] Exxon Corporation, Shell Oil Company, Gulf Oil Company, Phillips Petroleum Company, Petroleum Marketing Corporation, Commonwealth Oil Refining Company, Inc. and Ashland Oil Company. The Bills of Complaint and appellees' answers to the same are printed at A. 10-150.

[8] Ashland is primarily a refiner and marketer of petroleum products in that it produces less than 15% of the crude oil which it subsequently refines. J. App. at 90a-91a.

[9] P.M.C. is a wholly-owned subsidiary of Commonwealth and engages solely in the marketing of petroleum products.

market their petroleum products in Maryland at retail exclusively through company-operated stations, and do not market through independent dealers. Consequently, they also limited their challenges to the constitutional validity of paragraphs B and C of the Act.

Following the trial of the consolidated cases, the circuit court entered a judgment declaring that all provisions of the Act were unconstitutional and enjoined the enforcement of the Act by appellees (hereinafter referred to as the "State"). J. App. at 134a. The circuit court's holding was based primarily on the ground that the Act violated the due process clauses of the Maryland and federal constitutions. J. App. at 10a.

The State appealed from the judgment of the circuit court to the Court of Special Appeals of Maryland. A. 7. The Court of Appeals of Maryland issued a writ of certiorari prior to a decision by that intermediate appellate court. On February 18, 1977, the court of appeals reversed the judgment of the circuit court and held that all provisions of the Act were constitutional and valid. J. App. at la-45a. With respect to paragraphs B and C of the Act, the court denied the constitutional challenges of appellants and the other plaintiffs, holding "the Court below erred in holding that the Act was violative of the Due Process Clause of the Fourteenth Amendment . . .", J. App. at 16a; and that "the divestment provisions of the Maryland Act are not unconstitutional under the Commerce Clause." J. App. at 24a.

Following the denial of motions for reconsideration and for a stay of mandate by the court of appeals on April 13, 1977, and the entry of a judgment by the circuit court declaring the Act constitutional and valid,

Commonwealth is a refiner of petroleum products which is totally dependent upon foreign crude oil supplies. J. App. at 89a.

Continental and Kayo filed this appeal. They challenge the validity of paragraph C which prohibits producers and refiners of petroleum products from continuing to operate existing company-operated stations.

B. *Facts Material to Consideration of the Questions Presented*

Crude oil is neither produced nor refined in Maryland. J. App. at 19a. All gasoline offered for retail sale in Maryland is produced and refined outside of and then transported into the state, utilizing instrumentalities of interstate commerce. A. 193-94, 212-14, 216-17, 223-25, 231, 255-56, 257-58. The only operations engaged in by producers and refiners in Maryland are the distribution and marketing of their petroleum products both at retail and wholesale. A. 194, 212, 214, 216, 223, 231, 256, 258.

Continental Oil Company is engaged in the production, refining, transportation and marketing of petroleum products on a nationwide basis. J. App. at 68a. The gasoline brought by Continental into Maryland is refined at its Louisiana refinery and then transported through an interstate pipeline to a Baltimore terminal. J. App. at 68a. Continental does not operate any service stations or sell its branded gasoline ("Conoco") in Maryland. J. App. at 68a. Its gasoline is sold in Maryland at retail through fourteen retail service stations owned and operated by Kayo, its wholly-owned subsidiary.[10] J. App. at 70a. Continental also sells gasoline to wholesale purchasers doing business in Maryland and adjoining states. J. App. at 68a.

Because of the great number of retail outlets offering gasoline for sale and the myriad methods utilized in marketing that product to the Maryland consumer, the trial court concluded and the State conceded that the retail marketing of petroleum products in Maryland is a

[10] Kayo currently markets at retail in 18 states.

highly competitive industry. J. App. at 99a; State's Brief to the Maryland Court of Appeals at 7.

As of July 1, 1974, the effective date of the Act, 34 companies sold gasoline to consumers in Maryland under 40 different brands at approximately 3,800 retail service stations. A. 190-91. The vast majority of these outlets were and are operated by independent dealers. A. 190-91. Only 245 stations, approximately 6% of the total number of retail stations in Maryland, were company-operated.[11] A. 190-91. Of these, 209 stations were operated by 21 different producers and refiners. A. 190-91, 369. The remaining 36 company-operated stations were operated by independent marketers who neither produce nor refine petroleum.

The Maryland consumer is further served by a full range of activities and methods of operation existing in the Maryland retail gasoline market. Gasoline is offered for sale through, *inter alia,* conventional full service stations, full and partial self-service stations, combination service station-car wash facilities, turnpike stations, major service centers and truck stops. J. App. at 97a-98a. Generally, these stations may be divided into two types: (i) major brand stations and (ii) private brand stations. J. App. at 98a.

Kayo exemplifies and is identified in the industry as a private brand marketer. J. App. at 70a; A. 348. It markets its gasoline at retail in Maryland (and 17 other states) through high volume, low price, gasoline only, company-operated stations. A. 348-52. As a private brand marketer, it has the following characteristics common to all private brand marketers: (i) its brand is not advertised; (ii) it provides no repair services or facilities; (iii) it does not accept credit cards; and (iv) its

[11] Under paragraph C of the Maryland Act, a "company-operated station" is one which is operated directly by a company with its own employees, employees of a subsidiary company or commissioned agents.

principal marketing tool is the price of its gasoline, which is lower than the price of gasoline at a major brand station.[12] J. App. at 98a-99a. Private brand company-operated stations represent a consumer alternative, offering gasoline at a price one to four cents per gallon lower than that charged by major brand stations. A. 356, 451, 507, 517.

The vast majority of private brand stations are company-operated by producers and refiners, whereas most major brand stations are operated by Maryland independent service station dealers. J. App. at 99a. The private brand marketers' reliance upon company-operated stations is founded upon legal and economic considerations. In order for private brand marketers such as Kayo, Ashland and P.M.C. to compete with major brands, it is essential that their gasoline be offered to the consumer at a lower price. A. 356, 451, 507-08, 517. If both major and private brands were being offered for substantially the same price, the motoring public would choose to purchase the major brand because of a lack of recognition of the private brands which do not advertise, accept credit cards or offer repair services. A. 356, 452, 507-08, 517. Consequently, private brand marketers strive to reduce overhead, operate their stations longer hours, project a low-priced image and maintain competitive prices that are generally one to four cents per gallon below major brand marketers. A. 349-56, 449-53, 507-09. To achieve these results requires control over the operation, marketing and pricing practices of each station, which would be legally and practically unattainable by

[12] A major brand marketer (such as Exxon, Shell and Gulf) utilizes a different concept of marketing in that its brand name is widely recognized through advertising, it offers repair services, accepts credit cards, and places its marketing emphasis on methods of competition such as service and credit. J. App. at 98a.

marketing through dealer operation. A. 358, 451, 453, 455, 508, 517.

The impracticability of marketing through dealer operation is evidenced by the fact that the majority of private brand marketers market through company-operated stations. J. App. at 99a. Efforts by certain private brand marketers to market through dealer operation have proved unsuccessful. A. 450, 502-03, 517-18.

Under paragraph C of the Act, Kayo must either turn the operation of its retail service stations over to independent dealers or discontinue retail marketing of gasoline in Maryland. Should Kayo attempt to market through dealers, it will be unable to control its dealers' methods of operation and pricing practices. A. 357. Without control over these aspects of its marketing program, Kayo will be unable to dictate a lower price for its gasoline and remain competitive in Maryland. A. 357. For this reason, Kayo testified that it would have no choice but to cease operations in Maryland and withdraw from the state because it would be economically infeasible to continue to market at retail. A. 357-58. Its forced withdrawal will eliminate the direct flow of Kayo gasoline into the Maryland retail market from outside that state and deprive the consumer of the presence of this aggressive low-priced competitor.[13]

SUMMARY OF ARGUMENT

I. Due Process

Under paragraph C, producers and refiners must cease operating their existing retail service stations and either withdraw from the retail market or turn their

[13] Two other private-brand marketers, Ashland and P.M.C., testified at trial that if paragraph C of the Act is upheld, they will be forced to cease retail marketing in Maryland. A. 457, 507-10.

operations over to dealers. This choice will prohibit producers and refiners from continuing to use their property, impair their capital investments, and cause a loss of their revenues and profits generated by direct retail operations in Maryland. With respect to Kayo and other private brand marketers, the consequences of paragraph C are more drastic in that they will have no alternative but to withdraw from the Maryland retail market. Thus paragraph C will constitute a deprivation of valuable property rights.

Maryland enacted paragraph C under its police power. While a state's police power is necessarily broad when protecting its citizens' interests in the economic marketplace, the due process clause conditions its exercise by requiring that the means employed bear a rational relationship to a constitutionally permissible objective. If the means do not rationally approach the perceived problem, the statute is arbitrary and violates the fourteenth amendment. *Moore v. City of East Cleveland, Ohio,* 97 S. Ct. 1932 (1977); *Thompson v. Consolidated Gas Util. Corp.,* 300 U.S. 55 (1937); *Treigle v. Acme Homestead Assoc.,* 297 U.S. 189 (1936).

Appellants do not request the Court to pass upon the wisdom of paragraph C or to determine whether it promotes the public welfare. Admittedly, such a scrutiny is foreclosed by the Court's prior decisions in due process cases. Rather, appellants contend that the means selected by the Maryland Legislature, divestiture, bear no rational relationship to the Act's objectives, and that paragraph C is an invalid exercise of police power in violation of the due process clause.

The objective of paragraph C, as found by the Court of Appeals of Maryland, was to preserve competition. There is no rational relationship between preserving competition and forcing divestiture of existing company-operated stations. All parties as well as the

courts below agree that retail gasoline marketing in the State of Maryland is currently a highly competitive industry. To preserve competition in that market is to seek to maintain the status quo. The 209 company-operated stations operated by 21 separate producers and refiners play an important role in rendering the current market competitive. To reduce the number of competitive actors does not rationally relate to achieving the purported objective of preserving competition. Given the existing Maryland market, it is absurd.

The Maryland court believed that the divestiture provisions of the Act would prevent monopolistic control of the retail market by a few large oil companies and would assure the continued existence of independent retail dealers. Paragraph C, requiring divestiture of *existing* stations, does not relate in any way to the prevention of monopolistic control or the continued existence of dealers. As the market presently exists, 21 producers and/or refiners do not and cannot exercise such control. Further, the 209 stations operated by producers and refiners do not and cannot threaten the existence of approximately 3,500 independent dealers.

The means-ends test embodied in the concept of substantive due process has recently been reiterated in *Moore v. City of East Cleveland, Ohio*, 97 S. Ct. 1932 (1977). Because paragraph C fails to meet that test and arbitrarily deprives appellants of their property, it must fall as violative of the due process clause of the fourteenth amendment.

II. Commerce Clause

Along with being an arbitrary exercise of the State's police power, paragraph C also runs afoul of the commerce clause. It violates the principle that this country be one marketplace without artificial trade barriers.

A state statutory provision which discriminates against interstate competitors for the purpose of shielding domestic industries and markets from competition generated by those competitors violates the commerce clause. *Hunt v. Washington State Apple Advertising Commission*, 97 S. Ct. 2434 (1977); *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940). An examination of the true purpose and the practical effects of paragraph C manifests that it was both intended to and does discriminate against interstate competitors, while leaving Maryland local interests unaffected.

Gasoline is introduced into and offered for sale in the Maryland retail market through (1) 3,535 independent dealer stations, (2) 209 company-operated stations owned and operated by producers and refiners, and (3) 36 stations owned and operated by non-integrated marketers. Almost all of the independent dealers represent purely local interests. All 21 producers and/or refiners marketing gasoline at retail in Maryland through company-operated stations are interstate competitors. They compete as a separate and identifiable class with the remaining 3,571 other retail stations. Since all 21 producers and refiners must cease direct operation of their 209 stations, paragraph C removes that entire class of interstate competitors who serve as a vehicle for the introduction of their product into Maryland. The market is left to overwhelmingly local interests who will be effectively shielded from competition generated by a purely interstate class of competitors. As such, paragraph C's shield protecting purely local interests constitutes blatant discrimination.

Paragraph C also works an insidious discrimination directed at Kayo and other private brand marketers. In order for these marketers to compete, they must sell their gasoline at a price generally one to four cents per

gallon below the price charged by major brand marketers. Private brand marketers market through company-operated stations because it is the only way they can practically and legally maintain control over the pricing and marketing practices of their stations. This control cannot be maintained using dealer operation. It is for this reason that four private brand marketers testified at trial that they would be forced to withdraw from Maryland if paragraph C is upheld. Their withdrawal from the Maryland market will further protect and shield local interests from competition generated by interstate competitors.

Moreover, even if private brand marketers could convert their company-operated stations to dealer operation, paragraph C would still be discriminatory in that it would force them to alter their marketing practices, and increase their cost of doing business in Maryland. *Hunt v. Washington Apple Advertising Commission,* 97 S. Ct. 2434, 2445 (1977). The marketing practices and the costs of doing business of Maryland interests remain unaffected. Furthermore, paragraph C does not strip away from these Maryland interests the competitive and economic advantages which Kayo and other private brand marketers have earned for themselves in establishing and maintaining networks of efficient and economical company-operated stations. *Id.* at 2445-46.

Paragraph C will burden commerce in other respects. It will reduce the flow of gasoline into Maryland by forcing the withdrawal of certain private brand marketers who are unable to convert to dealer operation, and decrease the number of low-price retail service station outlets. It will impact other private brand marketers who do not yet produce or refine petroleum products in that it will inhibit their growth, or in the alternative, force them to discontinue retail marketing in Maryland upon acquisition of production or refining

capabilities. Finally, paragraph C could lessen the amount of gasoline available at wholesale in Maryland in that it will deprive crude deficient refiners of assured outlets which are vital to economic refinery operations.

The discriminative and burdensome effects of paragraph C are not justified by any legitimate local interest. Paragraph C does *nothing* to further the public interest of Maryland ascribed to it by its highest court. It has no relation to the preservation of competition.

Even assuming *arguendo* that paragraph C did in any way serve to preserve competition, the discrimination and burdens imposed by that provision are clearly excessive in relation to the local benefit. There are less drastic and discriminatory alternatives which serve Maryland's interest, and do so effectively without the impositions upon commerce visited by paragraph C of the Act.

ARGUMENT

I.

PARAGRAPH C OF THE ACT IS AN IMPROPER EXERCISE OF THE STATE'S POLICE POWER AND CONSTITUTES A DEPRIVATION OF PROPERTY WITHOUT DUE PROCESS OF LAW.

Maryland seeks by paragraph C to prohibit producers and refiners of petroleum products from continuing to operate existing company owned and operated retail stations. Producers and refiners historically have engaged in the direct retail sale of gasoline to consumers through company-operated stations both in Maryland and nationally. Prior to the enactment of paragraph C, it was lawful for a producer or refiner to market in this manner.[14]

[14] To continue to sell gasoline at retail through company-operated stations subjects producers and refiners to criminal sanctions under the Maryland Motor Fuel Inspection Law, MD. ANN. CODE, art. 56, §§ 157F(g) and 157K (1976 Cum. Supp.).

Since 1964, Kayo has directly operated nineteen retail stations in Maryland. A. 356. It presently operates fourteen such stations. A. 356. Each station represents a capital investment by Kayo in Maryland. As of June 30, 1975, Kayo's capital investiment in the land and improvements comprising its stations was $676,525. A. 215. In addition to its capital investment, Kayo has received substantial revenues and realized profits from its direct sales of millions of gallons of gasoline to Maryland purchasers. A. 215.

If paragraph C is upheld, Kayo will be required to discontinue the use of its property and the conduct of its retail business in its chosen manner. Kayo will have but two options. It could sell its stations and cease retail operations in Maryland, thereby losing the revenues and profits which have been generated from its retail operations. Kayo could also lease its stations or enter into agreements with dealers to operate the same. Should it choose this option, Kayo will be unable to dictate a lower price for its gasoline and thereby remain competitive in Maryland with major brand marketers. This consequence will reduce its revenues and profits and result in a substantial impairment of its capital investment.[15] To resort to either course of action mandated by paragraph C will necessarily prohibit Kayo from using its property and result in a deprivation of its valuable property rights. See *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55 (1937). See also, *Moore v. City of East Cleveland, Ohio*, 97 S. Ct. 1932, 1943 (1977) (Stevens, J., concurring).

Maryland has not mandated divestiture because of any transgression on the appellants' part violative of

[15] For the reasons previously stated, this alternative is not a viable one. If required to market through dealers, it will be economically infeasible for Kayo to continue marketing at retail in Maryland. *Supra* at 8-10.

the antitrust laws,[16] nor does paragraph C address itself to an industry deemed a regulated monopoly,[17] or one which clearly involves the public health or requires special expertise.[18] It requires producers and refiners to discontinue the direct sale of gasoline and to divest themselves of their company-operated stations through which they market gasoline at retail in Maryland because they are producers and refiners. Prior to the Maryland statute, no legislative body or court has required a corporation, vertically integrated through internal expansion, to divest itself of a segment of its operations solely because it was vertically integrated.[19]

Maryland enacted paragraph C under its police power. "[T]he term 'police power' connotes the time tested conceptional limit of public encroachment upon private interests." *Goldblatt v. Town of Hempstead, New York*, 369 U.S. 590, 594 (1962). In order to properly

[16] *See* United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948); Standard Oil Co. v. United States, 221 U.S. 1 (1911).

[17] *See* The Hepburn Act, 49 U.S.C. § 1(8) (1959) (The commodities clause of the Hepburn Act prohibits railroads from transporting commodities manufactured, produced or mined by them, thereby preventing railroads from utilizing their exclusive operating rights and attendant ratemaking powers from taking unfair advantage of non-rail competitors); The Public Utilities' Holding Company Act, 15 U.S.C. § 79(k) (1971) (This act requires public utility holding companies to dispose of unrelated utilities and holdings with the view towards consolidating them into single, intelligently integrated and organized systems).

[18] *See* North Dakota State Board of Pharmacy v. Snyder's Drug Stores, Inc., 414 U.S. 156 (1973) (pharmacies); Ferguson v. Skrupa, 372 U.S. 726 (1963) (debt adjusting); Williamson v. Lee Optical of Okla., Inc., 348 U.S. 483 (1955) (optometry).

[19] *See* Note, *Gasoline Marketing Divestiture Statutes: A Preliminary Constitutional and Economic Assessment*, 28 VAND. L. REV. 1277, 1315 (1975). The Court has held that direct retail marketing by a vertically integrated company is not per se unlawful. United States v. Columbia Steel Co., 334 U.S. 495, 519-26 (1948).

govern and protect the interests of its citizens, the police power is necessarily broad, including that authority which is exercised by the state in the marketplace. A state's authority to enact economic regulatory legislation under its police power is not without limitation, however, and the Court has long recognized that "states have [the] power to legislate against what are found to be injurious practices . . . so long as their laws do not run afoul of some specific federal constitutional prohibition." *Lincoln Federal Labor Union v. Northwestern I. & M. Co.*, 335 U.S. 525, 536 (1949).

In a series of cases, the most famous of which is *Lochner v. New York*, 198 U.S. 45 (1905), the Court frequently relied upon the fourteenth amendment to strike down economic regulatory legislation which it deemed capricious, unreasonable or unwise. The Court focused in these cases on the nature of the legislative objective itself. *See* Note, *Due Process Limitations on Occupational Licensing*, 59 VA. L. REV. 1097, 1112 (1973).

Nebbia v. New York, 291 U.S. 502 (1934) represents the seminal case in which the Court changed its approach in reviewing cases in which economic regulatory legislation was challenged as violative of due process. *Nebbia* and its progeny have established that the Court no longer judges the purpose or desired end of a legislative economic scheme. This change in approach did not abrogate the protection afforded by substantive due process; nor did it remove all limitations on the nature and extent of state regulation of business and commercial interests. The Court held in *Nebbia* that although due process does not prohibit governmental regulation for the public welfare, it does condition the exercise of the government's power "by securing that the end . . . be accomplished by methods

consistent with due process." *Id.* at 525. In this regard, the Court further stated that the means selected by a state must have "a real and substantial relation to the objective sought to be attained." *Id.*

Although the Court's approach in reviewing due process challenges changed in *Nebbia*, the exercise of governmental police power must still be accomplished by methods consistent with due process. In *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55 (1937) the Court reviewed a gas proration order issued by the Railroad Commission of Texas. The avowed purpose of the regulatory scheme was to conserve a natural resource of that state by preventing waste, while also protecting the correlative rights of the parties being regulated. In an opinion written by Justice Brandeis,[20] the Court stated that the proration orders "would not be valid *if shown to bear no reasonable relation* either to the prevention of waste or the protection of correlative rights, or if shown to be otherwise arbitrary." *Id.* at 69-70 (emphasis added). Since there was no reasonable relation between the means chosen (proration) and the purposes sought (prevention of waste and protection of correlative rights), the Court held that those means resulted in a deprivation of the plaintiffs' property in violation of the fourteenth amendment.

[20] During the *Lochner* era, Justices Brandeis and Holmes often dissented to the Court's review of the purposes of various state economic regulatory schemes. *See, e.g.*, Liggett Co. v. Baldridge, 278 U.S. 105, 112 (1928) (Brandeis, Holmes, J.J., dissenting); Ribnik v. McBride, 277 U.S. 350, 359 (1928) (Stone, Holmes, Brandeis, J.J., dissenting); Burnes Baking Co. v. Bryan, 264 U.S. 504, 517 (1924) (Holmes, Brandeis, J.J., dissenting). Their dissents were the forerunners to the Court's adoption of the standard of due process review in *Nebbia*. In later cases in which the Court examined the means of a statutory economic scheme rather than the ends, Justice Brandeis' dissents were relied upon in applying the proper standard of review. *See, e.g.*, North Dakota State Board of Pharmacy v. Snyder's Drug Stores, Inc., 414 U.S. 156 (1973).

Economic regulatory legislation was also held to be an invalid exercise of the police power in *Treigle v. Acme Homestead Assoc.*, 297 U.S. 189 (1936). Louisiana had sought to preserve the assets of its building and loan associations by enactment of a statutory scheme which redefined the method for the withdrawal of shareholders' interests. It was recognized that a state has an interest in and power of supervision and regulation to prevent injury and loss to members of building and loan associations. However, the sections of the statute in question did not "tend to conserve the assets of the association, to render it more solvent, or . . . to insure that its affairs [would] be administered so as to protect the investments of the continuing and withdrawing members." *Id.* at 196-97. Consequently, the exercise of police power was not deemed to have been exercised for an end that was in fact public; nor were the means reasonably adopted to the accomplishment of that end. The questioned sections were held to impair the obligation of the plaintiff's contract and to arbitrarily deprive him of vested property rights without due process of law.

A review of later due process cases discloses that the Court has scrutinized economic regulatory legislation to determine if the ends of a statutory scheme are accomplished by methods consistent with due process (i.e., whether the means selected by a state have a reasonable or rational relation to the objective sought to be attained). In *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483 (1955), for example, one of the state regulations held constitutional was a provision which prohibited optometrists from renting or occupying space in a retail store. The Court identified the legislative purpose as an attempt to free the profession from all taints of commercialism and held that the regulation had a "*rational relation to that objective* and therefore . . . [was not] beyond constitutional bounds."

348 U.S. at 491 (emphasis added). See also, *Ferguson v. Skrupa*, 372 U.S. 726, 733 (1963) (Harlan, J., concurring "on the ground that this state measure bears a reasonable relation to a constitutionally permissible objective."); *Daniel v. Family Security Life Ins. Co.*, 336 U.S. 220, 224 (1949) ("[We cannot] say that the statute has no relation to the elimination of those evils."); *West Coast Hotel Co. v. Parrish*, 300 U.S. 379, 391 (1937) ("[R]egulation which is reasonable in relation to its subject and is adopted in the interests of the community is due process.").[21]

The highest courts of a number of states have also scrutinized economic regulatory schemes to determine whether the objectives of a state's exercise of its police power were accomplished by methods consistent with due process under the fourteenth amendment. In *Berger v. State Board of Hairdressing*, 371 A.2d 1053 (R.I. 1977), the Rhode Island Supreme Court invalidated a state statutory provision which barred schools teaching hairdressing and cosmetic therapy from charging for supplies used on any person acting as a subject for student instruction. The protection of the public from untrained barbers was deemed a permissible purpose. The court held that the provision in question did not bear a reasonable relationship to that purpose and, therefore, ran "afoul of the fourteenth amendment guarantee of due process." *Id.* at 1055. See also, *Baffoni*

[21] In other cases before the Court which generally are cited as proof of the demise of economic substantive due process, the issue of whether the means rationally approached the legislative objective was not argued or was too obvious to merit discussion. *See, e.g.*, North Dakota State Bd. of Pharmacy v. Snyder's Drug Stores, Inc., 414 U.S. 156 (1973); Day-Brite Lighting, Inc. v. Missouri, 342 U.S. 421 (1952); Lincoln Federal Labor Union v. Northwestern Iron & Metal Co., 335 U.S. 525 (1949); Olsen v. Nebraska, 313 U.S. 236 (1941). In these cases the wisdom of the legislative scheme was questioned rather than the rationality between the ends and the means.

v. State Dept. of Health, 373 A.2d 184 (R.I. 1977), *citing Williamson v. Lee Optical of Okla., Inc.,* 348 U.S. 483, 487-88 (1975).

In *United States Brewers' Association, Inc. v. State,* 192 Neb. 328, 220 N.W.2d 544 (1974) the Supreme Court of Nebraska considered the constitutionality of a statute which regulated the manner in which a manufacturer could establish or terminate an existing sales distributorship. The avowed purpose of the act was to foster and promote temperance and obedience to the law. The court held that "[t]here is no reasonable relationship between the act and the fostering or promoting of temperance and obedience to the law . . . ." 220 N.W.2d at 549. As such, the court invalidated the statute because it constituted an unreasonable exercise of the police power in violation of both the state and federal constitutions. See also, *S[illegible] v. A. J. Bayless Markets, Inc.,* 86 Ariz. 193, 342 P.2d 1088 (1959); *United Interchange, Inc. v. Spellacy,* 144 Conn. 647, 136 A.2d 801 (1957); *Chicago Title & Trust Co. v. Village of South Lombard,* 19 Ill. 2d 98, 166 N.E.2d 41 (1960); *Pacesetter Homes, Inc. v. Village of South Holland,* 18 Ill. 2d 247, 163 N.E.2d 464 (1960); *Gilbert v. Mathews,* 186 Kan. 672, 352 P.2d 58 (1960). *See also, Commonwealth v. Stone,* 191 Pa. Super. 117, 155 A.2d 453 (1959); *Fasino v. Mayor,* 122 N.J. Super. 304, 300 A.2d 195, *aff'd* 129 N.J. Super. 461, 324 A.2d 77 (1973).

Appellants do not request the Court to pass upon the wisdom of paragraph C or to determine whether it promotes the public welfare. Admittedly, such a scrutiny is foreclosed by the Court's prior decisions in due process cases. Rather, appellants contend that the means selected by the Maryland Legislature, divestiture, bear no rational relationship to the Act's objectives, and that paragraph C is an invalid exercise of police power in violation of the due process clause.

The Court of Appeals of Maryland stated in its opinion that "the courts are under a special duty to respect the legislative judgment as to the proper means of solving the problem." J. App. at 15a. Legislative judgment should be respected; therefore, all legislation is presumed to be constitutional. *See Thompson v. Consolidated Gas Utilities Corp.,* 300 U.S. 55, 69 (1937). However, when legislation does not rationally approach what is perceived to be the problem, it constitutes an arbitrary exercise of the police power. *See Usery v. Turner Elkhorn Mining Co.,* 428 U.S. 1, 21 (1976).

Appellees contend that paragraph C bears a rational relation to a constitutionally permissible objective, the preservation of competition. As found by the trial court, "[r]etail petroleum marketing in the State of Maryland is and has been a highly competitive industry." J. App. at 99a. Appellees have conceded this fact.[22] Private brand, company-operated stations are important competitive forces in the marketplace.[23] Kayo and other private brand marketers (e.g., Ashland and P.M.C.) exert a pro-competitive influence in the Maryland market, traditionally offering consumers the lowest gasoline prices in the state. It is essential for private brand marketers to sell at retail through company-operated stations. A. 356, 451, 507-08, 517. Forced divestment of existing stations will impair private brand operations or cause these marketers to discontinue them. To impair or eliminate existing competitors from a currently highly competitive market under the guise of preserving competition strains all bounds of reasonableness or rationality. Competition cannot be served by a reduction in the number of competitive

[22] State's Brief to the Maryland Court of Appeals at 7.

[23] The only expert who testified on behalf of the State at trial conceded that the elimination of such private brand marketers would be anti-competitive. A. 624, 630.

actors involved. To conclude otherwise is patently absurd.

The Court of Appeals found that the Maryland Legislature was presented with evidence that refiners and producers were favoring company-operated stations in the allocation of gasoline;[24] that because of an inability to obtain adequate supplies of gasoline, some service station dealers had been forced to close;[25] and that many dealer operated stations were being converted to company operation. J. App. at 14a. The court then stated as follows (J. App. at 14a-15a):

> "The Legislature could reasonably conclude that control of the retail gasoline market by producers and refiners would decrease competition and that the continued existence of independent retail dealers was necessary to preserve competition. Exclusion of producers and refiners may conceivably be a reasonable means of preserving competition and preventing monopolistic control of gasoline marketing by a few large oil companies."
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> * * * * * *

[24] Evidence of misallocation was gleaned from reports prepared by the State Comptroller of the Treasury's office. The Comptroller's reports were not introduced at trial as evidence of the truth of the contents thereof. A. 548-49. Rather, they were admitted as evidence which had been submitted to the legislature. The author of the report testified at trial that the investigation undertaken by the Comptroller's office regarding allocation disclosed no evidence that producers and refiners misallocated their products between company-operated stations and dealer stations. A. 550, 556, 564. The author of the Comptroller's report, who also drafted the Act in question, further testified that there was no relationship between paragraphs B and C of the Act and the survey results received by the Comptroller. A. 565; J. App. at 116a.

[25] Dealers were forced to close or limit hours of operation because of an inability to obtain adequate supplies of gasoline. However, the trial court found from all of the evidence that this shortage was "directly related to the OPEC embargo," and was not caused by misallocation on the part of producers and refiners. J. App. at 130a.

> "The Legislature . . . has determined that competition from producers and refiners could ultimately result in the destruction of a competitive gasoline market."

The above passage of the court's opinion ascribes the objective motivating the Maryland Legislature to enact paragraphs B and C. That objective was to preserve competition by preventing monopolistic control of the retail gasoline market by a few large oil companies, and assuring the continued existence of independent retail dealers. The court did not focus its attention upon paragraph C alone in determining whether divestiture of *existing* stations bore a rational relation to that objective. Such an examination compels but one conclusion — divestiture fails to rationally approach the perceived problem.

Paragraph C bears no relation to "preventing monopolistic control of gasoline marketing by a few large oil companies." J. App. at 14a. The existing Maryland market consists of approximately 3,800 retail stations. Twenty-one producers and/or refiners operate 209 retail outlets. No one company or group of companies selling gasoline through 209 company-operated stations exert monopolistic control over the Maryland retail market. Monopolistic control would contemplate a massive increase in the numbers of company-operated stations. Paragraph C, prohibiting producers and refiners from operating their *existing* stations in a highly competitive market, fails to address this imagined danger.

Nor does paragraph C constitute a rational approach to assuring the continued existence of independent retail dealers so as to preserve competition. No one argues or even suggests that the existence of approximately 3,500 independent dealers is threatened by the continued operation of 209 company-operated stations located throughout Maryland.

The Maryland court believed that independent dealers might be threatened by the conversion of their stations to company operations or by their inability to obtain adequate supplies of gasoline. J. App. at 14a. Paragraph C has no connection whatsoever with conversion of dealer stations. Further, it is not a rational means by which to insure that dealers are able to obtain adequate supplies of gasoline. Paragraph F is intended to address the objective of uniform apportionment of gasoline to dealers in times of shortage.[26] Thus, paragraph C does not serve as the rational means to the accomplishment of these objectives.

Kayo and other private brand marketers such as Ashland and P.M.C. market exclusively by company operations in Maryland. Therefore, they have no dealers to convert to company operation; nor are they able to unfairly allocate supplies to their company-operated stations and so discriminate against any dealer. It is arbitrary and irrational to require producers and refiners who market exclusively through company-operated stations to close their existing stations so as to preserve the existence of dealers supplied by other producers and refiners.

In contending that paragraph C bears a rational relation to the Act's objectives, appellees rely solely upon the testimony of their expert at trial.[27] Appellees state that their expert testified that the Act "would aid competition by denying producers and refiners the

[26] See also, Federal Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§ 751 *et seq.* which also prohibits misallocation of gasoline. In Moore v. City of East Cleveland, Ohio, 97 S. Ct. 1932, 1936 n.7 (1977), the Court recognized that other legislative measures specifically addressed to the purported problem bear upon the issue of rationality. See also, Triegle v. Acme Homestead Assoc., 297 U.S. 189, 196 (1936).

[27] State's Motion before the Court to Dismiss or Affirm at 8-9.

power to focus windfall profits from crude prices upon their competitors."[28] In fact, he testified that the "*increased* direct operation of service stations" could bring about that result. A. 594. Appellees further state that their expert testified that the Act would increase "the amount of gasoline available to independent non-integrated companies who provide the only source of aggressive price competition in the retail gasoline market." In fact, he stated that "the *more* direct operation" of company-operated stations might lessen the amount of gasoline available to that class of competitors. A. 594. Thus, appellees' reliance on their expert's testimony is misplaced in both instances. His testimony fails to provide any nexus between divestiture of *existing* stations and those objectives.

Recently, the Court stated in *Moore v. City of East Cleveland, Ohio,* 97 S. Ct. 1932, 1937 (1977):

> "Substantive due process has at times been a treacherous field for this Court. There are risks when the judicial branch gives enhanced protection to certain substantive liberties without the guidance of the more specific provisions of the Bill of Rights. As the history of the *Lochner* era demonstrates, there is reason for concern lest the only limits of such judicial intervention become the predilections of those who happen at the time to be Members of this Court. That history counsels caution and restraint. But it does not counsel abandonment . . ." (footnote omitted).

In *Moore* a city zoning ordinance was held in violation of substantive due process because it had a "tenuous relation" at best to its purported objective.[29]

[28] The record is devoid of any evidence suggesting that producers or refiners focused "windfall profits" upon competitors. Such a practice could constitute an unlawful practice violative of federal and Maryland antitrust laws.

[29] See also concurring opinion of Justices Brennan and Marshall, agreeing that the ordinance was "not a rational means of achieving the ends" the city claimed for its

Id. at 1936. Thus, the ordinance was an arbitrary exercise of the police power and violated the appellant's liberty interest. Paragraph C's drastic effect is visited upon Kayo's property rights. In *Moore,* "a tenuous relation" failed to comport with due process. The instant case admits of no rational relation between paragraph C and the Act's objective, the preservation of competition.

Under paragraph C, appellants must cease operating their existing retail service stations and either withdraw from the retail market or turn their operations over to dealers. The Court of Appeals of Maryland was of the opinion that this result would serve to preserve competition in Maryland. As has been demonstrated, divestiture of *existing* stations in no way rationally approaches this objective. Instead, as found by the trial court below, paragraph C is designed to benefit one class of merchants to the detriment of another.[30] It presents a "glaring instance of the taking of one man's property and giving it to another", *Thompson v. Consolidated Gas Utilities Corp.,* 300 U.S. 55, 80 (1937), and constitutes a deprivation of appellants' property rights guaranteed by the due process clause.

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ordinance. 97 S. Ct. at 1940; concurring opinion, Justice Stevens, "[a] community which attacks these problems by restricting the composition of a household is using a means not reasonably related to the end it seeks to achieve." *Id.* at 1946 n.16. In dissent, Justices Stewart, Rehnquist and White also recognized the applicability of the means-ends test in substantive due process cases. *Id.* at 1956 n.10 (Stewart, Rehnquist, J.J., dissenting) and at 1961 (White, J., dissenting).

[30] J. App. at 131a.

II.

PARAGRAPH C OF THE ACT VIOLATES THE COMMERCE CLAUSE BECAUSE IT DISCRIMINATES AGAINST AND UNDULY BURDENS INTERSTATE COMMERCE.

Paragraph C of the Act mandates that all producers or refiners of petroleum products discontinue the operation of their existing company-operated stations and cease marketing their petroleum products directly to the consumer in Maryland. The reach of that provision extends far beyond the Maryland retail market and implicates interstate commerce.

Pike v. Bruce Church, Inc., 397 U.S. 137 (1970), holds that where a statute "regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142. Because paragraph C fails to comport with this standard, it is repugnant to the commerce clause.

A. *Paragraph C Does Not Regulate Even-Handedly, and Indeed Substantially Burdens Interstate Commerce.*

1

A state statute discriminating against interstate competitors for the purpose of shielding domestic industries and markets from those competitors violates the commerce clause. *Hunt v. Washington Apple Advertising Commission,* 97 S. Ct. 2434 (1977); *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318 (1977); *Polar Ice Cream & Creamery Co. v. Andrews,* 375 U.S. 361 (1964); *Halliburton Oil Well Cementing Co. v. Reily,* 373 U.S. 64 (1963); *West Point Wholesale Grocery Co. v. City of Opelika,* 354 U.S. 390 (1957); *Memphis Steam Laundry v. Stone,* 342 U.S. 389 (1952);

Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951); *H. P. Hood & Sons, Inc. v. DuMond,* 336 U.S. 525 (1949); *Nippert v. Richmond,* 327 U.S. 416 (1946); *Best & Co. v. Maxwell,* 311 U.S. 454 (1940); *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511 (1935); *Buck v. Kuykendall,* 267 U.S. 307 (1925). Discrimination is repugnant to the principles embodied in the commerce clause because "the Clause was designed in part to prevent trade barriers," *Hughes v. Alexandria Scrap Corp.,* 426 U.S. 794, 807 (1976), and "to create an area of free trade among the several States." *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318, 328 (1977).

As exemplified in *Dean Milk Co. v. City of Madison,* 340 U.S. 349 (1951), the Court may seek out the true impetus and motivation prompting legislative action and analyze the actual probable working of that action when commerce is involved. *Id.* at 354. See also, *Hunt v. Washington Apple Advertising Commission,* 97 S. Ct. 2434, 2445 (1977); *Buck v. Kuykendall,* 267 U.S. 307 (1925). It may review the evidence and determine for itself the true purposes and effects of a statute. *Great Atlantic & Pacific Tea Co. v. Cottrell,* 424 U.S. 366, 375 (1976).

A review of the record establishes that the true purpose of paragraph C was to shield local Maryland dealers from competition generated by their interstate competitors. A retail dealers' association provided a primary impetus for divestiture in Maryland. A. 755. Such associations urge divestiture nationally. See Note, *Gasoline Marketing Divestiture Statutes: A Preliminary Constitutional and Economic Assessment,* 28 VAND L. REV. 1277, 1279, 1307 (1975). The State in its initial response to appellants' bill of complaint contended that the Act was designed to promote "the economic welfare and continuing existence of the retail service station dealers." A. 54. The State's only expert witness

admitted at trial that the Act would protect dealers against competition from company-operated stations. A. 613. The trial court below specifically found:

> "In all the more than one hundred eighty-five pounds of pleadings, motions, briefs, exhibits and depositions before this court, there is *no concrete evidence* that the act was justified as to the classes of operators singled out to be affected in order to promote the general welfare of the citizens of the State. *Rather, it is apparent that the entire bill was designed to benefit one class of merchants to the detriment of another* . . . ." J. App. at 131a. (emphasis added).

An examination of the Maryland retail gasoline market demonstrates that in practical effect paragraph C will shield local dealers from interstate competitors. Gasoline is introduced into and offered for sale in the Maryland retail market through (1) independent dealer stations, (2) company-operated stations owned and operated by producers and refiners, and (3) stations owned and operated by non-integrated marketers. Of the approximately 3,780 retail outlets in Maryland, 3,535 are operated by independent dealers, 209 are operated by 21 producers and refiners, and 36 are operated by non-integrated marketers.[31] A. 190-91.

Almost all of the independent dealers represent purely local interests. All 21 producers and refiners marketing gasoline at retail in Maryland through company-operated stations are interstate competitors. They compete as a separate and identifiable class with the remaining 3,571 retail stations, all but 36 of which are operated almost exclusively by local interests — independent dealers.

Paragraph C of the Act prohibits all producers and/or refiners from continuing to operate their

[31] Of the 36 outlets operated by gasoline marketers who are neither producers nor refiners, an undetermined number may not be Maryland based businesses.

existing company-operated stations. It mandates that they cease marketing their petroleum products directly to the consumer. As that provision clearly commands, "[t]he station must be operated by a retail service station dealer." Since all 21 producers and refiners must cease direct operation of their 209 stations, paragraph C precludes that entire class of interstate competitors from continuing to directly introduce their product into the Maryland retail market. The market will be left to overwhelmingly local interests who effectively will be shielded from competition generated by a purely interstate class of competitors.

The Court has often struck down state taxing schemes imposed upon interstate competitors which had the practical effect of curtailing or impairing their presence in a given market. See, e.g., *Best & Co. v. Maxwell,* 311 U.S. 454 (1940). Such schemes designed to protect local interests have been found to be inherently discriminatory in violation of the commerce clause. In *Best & Co.,* the Court struck down such a scheme, holding:

> "[t]he freedom of commerce which allows the merchants of each state a regional or national market for their goods is not to be fettered by legislation, the actual effect of which is to discriminate in favor of intrastate businesses, whatever may be the ostensible reach of the language." *Id.* at 457.

Paragraph C's prohibition goes beyond imposing a tax on interstate competitors. It excludes them from directly competing in the retail marketplace.

The Court of Appeals of Maryland believed that the divestiture provisions of the Act did not discriminate against out-of-state interests as opposed to local interests. It reasoned that if there were local producers and/or refiners, they would also be subject to the Act. J. App. at 19a-20a. In fact, there are no local producers or

refiners which could be subject to the Act. Moreover even if there were local producers and refiners, their presence in Maryland would not be controlling. In *Dean Milk Co. v. City of Madison,* 340 U.S. 349 (1951), the Court struck down an ordinance requiring all milk sold in the city to be bottled within five miles of the city center. The Court held that it was immaterial that other intrastate operators were subject to the same prohibition as the interstate competitor. See also, *Minnesota v. Barber,* 136 U.S. 313, 336 (1890) ("A burden imposed by a state upon interstate commerce is not to be sustained simply because the statute imposing it applies alike to the people of all the States, including the people of the State enacting such statutes").

In *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951), the Court held a Madison regulation violative of the commerce clause which in practical effect precluded interstate competitors from introducing their product into the Madison market, thereby shielding a major local industry against competition from without the state. The erection of that economic barrier against competition "plainly discriminate[d] against interstate commerce." *Id.* at 354.

Paragraph C represents no less of a formidable barrier against the continuing presence of interstate competitors in the Maryland retail gasoline market. An entire identifiable class of competitors is to be removed from that market. The vehicle that they represent for the direct introduction and retail sale of their product is to be stopped at Maryland's borders as effectively as in *Buck v. Kuykendall,* 267 U.S. 307 (1925). As such, paragraph C's shield protecting purely local interests constitutes blatant discrimination.

2

Paragraph C works an insidious discrimination directed at Kayo and other similarly situated private

brand marketers. As demonstrated at trial, such marketers will be unable to continue retail marketing in Maryland through dealers for legal and economic reasons. Kayo markets its gasoline in Maryland and nationally through company-operated stations. A. 348. Its principal marketing tool is the price of its gasoline. In order for private brand marketers in general, and Kayo in particular, to compete with a major brand, it is essential that they sell gasoline at a price generally one to four cents per gallon below major brand marketers. A. 356.

To achieve this result requires control over the operation, marketing and pricing practices of each station. A. 357. Such control was described by the State's expert at trial as "absolutely the crux of the success of the discount marketer," A. 628, and cannot be accomplished legally by marketing through independent retail dealers.[32]

Furthermore, efforts by private brand marketers to retail through dealers have demonstrated the critical importance of maintaining control over the operation and pricing practices of their stations. These marketers testified at trial that previous efforts to market through dealers resulted in a loss of control over their retail operations which adversely affected their ability to compete. A. 452, 508, 517-18.

Absent the ability to control price and method of operation, Kayo and other private brand marketers will be unable to remain competitive in the Maryland retail market. For this reason, Kayo, Ashland and P.M.C. testified at trial that they would be forced to close their retail outlets rather than operate them through dealers.

[32] *See* Maryland Gasoline Products Marketing Act, Md. Com. Law Code Ann. § 11-304(c); Maryland Antitrust Laws, Md. Com. Law Code Ann. §§ 11-201 *et seq.*; Federal Antitrust Laws, 15 U.S.C. §§ 1 *et seq.*

A. 357-58, 457, 507-10.[33] Their withdrawal from the Maryland market will shield local independent dealers from direct competition generated by these interstate competitors.

Even if Kayo and other private brand marketers could remain in the Maryland market and retail through dealers, paragraph C would still discriminate against them.[34] To require private brand marketers who market through company-operated stations to alter their national marketing practice and convert to dealer operation in Maryland will adversely affect them economically. Administrative expenses would have to be incurred to establish, maintain and supervise dealer operations. Loss of control over retail price and dealer operations would probably result in a decrease of gallonage sold. The resulting impact would be a decrease in their return on investment and an increase in their cost of doing business in Maryland.

In *Hunt v. Washington State Apple Advertising Commission*, 97 S. Ct. 2434 (1977), the Court reviewed a North Carolina statute requiring, *inter alia*, "all closed containers of apples sold, offered for sale or shipped into the State to bear 'no grade other than the

[33] The Maryland court did not deem significant the testimony of Kayo, P.M.C. and Ashland that the Act would require them to withdraw from the Maryland market because of the absence of a "firm decision" to withdraw. To require a final corporate decision prior to a determination of the Act's validity is unreasonable. Greater weight should have been attached to this uncontroverted evidence compelling the inevitable conclusion that a prohibition against company-operated stations would force their withdrawal from the market.

[34] Kayo and P.M.C. market exclusively through company-operated stations and have no dealers. A. 348 and A. 450. Ashland also markets principally through company-operated stations except for a limited geographical area near its refinery in Ashland, Kentucky where it is able to market its recognized brand through dealers. A. 501-03.

applicable U.S. grade or standard.'" *Id.* at 2438. An agency of the State of Washington charged with the promotion and protection of the Washington apple industry challenged the statute as being discriminatory against interstate competitors insofar as it prohibited the display of Washington State grades on closed containers of apples shipped into North Carolina.

The Court, looking to the practical effect of the statute, found that it unduly discriminated against North Carolina's Washington competitors. One of the forms of discrimination found by the Court was that the statute would have the effect of:

> "raising the costs of doing business in the North Carolina market for Washington apple growers and dealers, while leaving those of their North Carolina counterparts unaffected. As previously noted, this disparate effect results from the fact that North Carolina apple producers, unlike their Washington competitors, *were not forced to alter their marketing practices in order to comply with the statute.* They were still free to market their wares under the U.S.D.A. grade or none at all as they had done prior to the statute's enactment. *Obviously, the increased costs imposed by the statute would tend to shield the local apple industry from the competition of Washington apple growers and dealers. . . .*" *Id.* at 2445 (emphasis added).

An examination of the practical effect of paragraph C compels the same conclusion as was reached in *Hunt*. Economic burdens are visited upon Kayo and other interstate competitors in that their costs of doing business in Maryland will be increased, while those of their Maryland competitors will remain unaffected. This disparate effect will result from the fact that Maryland retail dealers, unlike Kayo, are not forced to alter their marketing practices in order to comply with paragraph C. Nor does paragraph C strip away from Maryland retail dealers the competitive and economic

advantages which Kayo earned for itself in establishing and maintaining a network of efficient and economical company-operated stations. *Id.* at 2445-46.

3

Paragraph C's discriminative effect upon an entire class of interstate competitors in general, and upon certain private brand marketers such as Kayo in particular, will burden commerce in other respects.

The forced withdrawal of Kayo, Ashland and P.M.C. from the Maryland retail market will halt the flow of their gasoline into the state. These companies sell gasoline at retail in Maryland through 51 company-operated stations at prices generally one to four cents per gallon below major brand dealers. In 1974, they sold in excess of 60 million gallons of gasoline at their Maryland company-operated stations. A. 213, 259, 464. In addition to reducing a substantial volume of gasoline heretofore sold to the Maryland consumer, their withdrawal will reduce the number of low-priced competitors from whom gasoline could be purchased.

The effect of paragraph C will further impact other non-integrated marketers currently selling gasoline at retail in Maryland exclusively through company-operated stations. Should these marketers acquire either production or refining capabilities they will be required to cease retailing through company-operated stations and convert the same to dealer operation. At least one such marketer, Hudson Oil Company, testified at trial that it planned to construct or acquire a refinery to provide it with its own source of refined petroleum products. A. 518. It further testified that if the Act was upheld and the company acquired refining capabilities, it would dispose of its five stations and cease retail operations in Maryland.[35] A. 519. In 1976, Hudson Oil

[35] Hudson Oil Company markets exclusively through company-operated stations in 36 states.

Company acquired a refinery. Oil & Gas Journal, Annual Refinery Issue at 117 (March 28, 1977). Since that marketer is now subject to paragraph C, implementation of that provision will further reduce both the volume of gasoline introduced into the Maryland market and the number of low-priced marketers in the state.

Forced divestiture of existing company-operated stations will also burden interstate commerce by its impact upon the availability of refined petroleum to Maryland wholesalers and non-integrated marketers. Crude deficient refiners such as Ashland are a principal source of wholesale supply for those marketers in Maryland. A. 504, 623-24. Ashland markets at retail in Maryland exclusively through company-operated stations and testified at trial that it would withdraw from that market rather than convert its stations to dealer operation. A. 507-10. Forced closure of their company-operated stations would deprive Ashland of assured outlets for its refined products which are vital to economic refinery operations. A. 505-07. Elimination of company-operated stations and the resulting burden on economical refinery operations, A. 504, would impair or possibly eliminate Ashland's ability to supply refined petroleum products to other independent marketers in Maryland who either purchase that product for resale or sell the same directly to the motoring public. A. 504-05. To the extent that the availability of refined petroleum products to non-integrated marketers will be curtailed,[36] paragraph C will burden the flow of interstate products into Maryland.

[36] Mary Hudson, a non-integrated marketer of gasoline, testified that the gasoline sold at her Maryland stations was purchased from Ashland. A. 517. Approximately 60% of Ashland's gasoline is sold to wholesale customers. A. 504.

4

As demonstrated above, paragraph C discriminates against an entire class of interstate competitors in general, and against certain private brand marketers in particular. It increases operating costs, impairs efficiency and hampers competition with purely local interests. Consequently, it interferes "with the natural functioning of the interstate market either through prohibition or through burdensome regulation." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976). As such, paragraph C's burdens upon interstate commerce are direct and substantial.

The Court of Appeals of Maryland was of the opinion that the Act did not burden commerce because it "merely regulate[d] a wholly intrastate activity, the retail marketing of gasoline within the state," and "[p]roducers and refiners would still remain free to import and sell petroleum products to wholesalers and retail service station dealers." J. App. at 18a-19a. The court's opinion ignored the uncontradicted evidence before it, the trial court's findings of fact and the realities of the Maryland retail gasoline market.

To label the retail sale of gasoline in Maryland "a wholly intrastate activity" is to fail to comprehend the Supreme Court's interpretations of the scope of the commerce clause. In determining whether interstate commerce is involved, the Court considers whether the activity in question implicates or affects commerce. *Wickard v. Filburn*, 317 U.S. 111 (1942). Inquiry as to whether interestate commerce is burdened is not confined to the single segment of a commercial process which is directly subjected to prohibition or regulation. *Allenberg Cotton Co., Inc. v. Pittman*, 419 U.S. 20 (1974); *Nippert v. City of Richmond*, 327 U.S. 416 (1946). *Cf. National Labor Relations Board v. Reliance Fuel Oil Co.*, 371 U.S. 224 (1963).

In *Nippert v. City of Richmond*, 327 U.S. 416 (1946), petitioner was arrested for soliciting business without obtaining a license and paying a city tax. The Court invalidated the state license requirement and the licensing tax because they discriminated against commerce. The city argued that the incident being taxed was purely local in nature, and that the tax was not levied on a transaction that was part of interstate commerce. The Court, in rejecting this argument, stated:

> "For the situation is difficult to think of in which some incident of an interstate transaction taking place within a state could not be segregated by an act of mental gymnastics and made the fulcrum of the tax. All interstate commerce takes place within the confines of the states and necessarily involves 'incidents' occurring within each state through which it passes or with which it is connected in fact. And there is no known limit to the human mind's capacity to carve out from what is an entire or integral economic process particular phases or incidents, label them as 'separate and distinct' or 'local' and thus achieve its desired result." *Id.* at 423.

All gasoline sold in Maryland is produced and refined outside the state. J. App. at 19a. *See Daniel v. Paul*, 395 U.S. 298 (1969). Instrumentalities of interstate commerce are employed in transporting the gasoline into Maryland. Gasoline brought into Maryland is sold to persons traveling in interstate commerce. *See Katzenbach v. McClung*, 379 U.S. 294 (1964). The retail sale of gasoline is merely one step removed from its consumption by the motoring public.

Paragraph C is directed at the retail marketing of gasoline in Maryland. As such, it directly affects a single segment of a commercial process that is national in scope. That process, from crude production to ultimate consumption constitutes a stream of commerce. *See Federal Trade Commission v. Sun Oil Co.*, 371 U.S. 505 (1963); *Standard Oil Co. v. Federal Trade Commission*, 340 U.S. 231 (1951). State regulation of the retail segment of that stream implicates interstate commerce. *See Panhandle Eastern Pipe Line Co. v. Public Service Commission*, 332 U.S. 507 (1947). Consequently, interstate commerce is clearly involved in the regulation imposed by paragraph C.

Nor does the Maryland court's conclusion that producers and refiners "would still remain free" to sell petroleum products to wholesalers and dealers obviate paragraph C's burdens on commerce. Uncontradicted evidence from Kayo, Ashland and P.M.C. compels the conclusion that conversion to dealer operation is not a viable economic alternative.[37] The alternative of redirecting sales to wholesalers and dealers does not cure paragraph C's commerce clause infirmity.

In *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951), the dissenting opinion noted that Dean could easily have complied with the ordinance by simply constructing a facility to pasteurize its milk within five miles of the center of Madison. The view was expressed that Dean's personal preference to pasteurize in Illinois kept its milk out of Madison rather than the ordinance in question. *Id.* at 357. Although this view was not addressed in the majority opinion in *Dean*, it was rejected in *Halliburton Oil Well Cementing Co. v. Reily*, 374 U.S. 64 (1963). In that case, the Court deemed Dean's "personal preference" to pasteurize elsewhere "the essence of a national unrestricted market." *Id.* at 73n.7. Paraphrasing from *Halliburton*, "if, before striking down a burden on interstate commerce this Court had to look to the record for economic justifications for [Kayo's exclusive use of company-operated

[37] Hudson Oil Company, now a refiner-marketer, also testified that it would have to dispose of its stations in Maryland if paragraph C is upheld. A. 519.

stations as opposed to marketing through dealers] . . ., the free flow of commerce would disappear before our very eyes." *Id.* See also, *Uni-Worth Enterprises, Inc. v. Cleveland, Miss.*, 412 F. Supp. 349, 352 (N.D. Miss. 1976). Consequently, to limit Kayo's market to wholesale purchasers and retail dealers cannot constitutionally serve as a substitute to engaging in the vital segment of its operations — direct retail sales.

B. *The Discriminatory Burdens Imposed By Paragraph C Cannot Be Justified By Any Legitimate Local Interest.*

In *Hunt v. Washington Apple Advertising Commission,* 97 S. Ct. 2434 (1977), the Court struck down on commerce clause grounds a North Carolina statute which did "remarkably little to further" that state's legitimate public interest. *Id.* at 2446. In the instant case, paragraph C does *nothing* to further the putative public interest of Maryland ascribed to it by its highest court.

The Maryland court was of the opinion that its State's interests would be furthered in that the divestiture provisions would "preserve competition within the retail gasoline marketing industry in Maryland." J. App. at 19a. Two reasons were advanced by the court for its opinion. First, it stated that the Act would prevent producers and refiners from favoring company-operated stations over dealers in the allocation of gasoline during periods of shortage, thereby forcing dealers out of business. Second, it would halt the recent trend of increased direct operation of service stations by producers and refiners, which "if allowed to continue, could substantially decrease competition and lead to the control of that market by a few major oil companies." J. App. at 19a.

To preserve competition is to seek to maintain the status quo. Although Maryland unquestionably possesses an interest in preserving competition within the retail gasoline marketing industry, paragraph C fails to effectuate that goal. Retail petroleum marketing in Maryland is presently a highly competitive industry. J. App. at 99a. Private brand company-operated stations operated by, *inter alia,* Kayo, Ashland and P.M.C. are important competitive forces in the Maryland market. The State's expert conceded at trial that the elimination of such private brand marketers would be anti-competitive. A. 630. It is patently absurd to conclude that competition can or will be preserved by the elimination of existing competitors from an existing highly competitive market.

Elimination of *existing* company-operated stations does not relate in any manner to halting a trend in *increased* direct operation of service stations by producers and refiners which, according to the Maryland court, could substantially decrease competition. This goal is not addressed by paragraph C. Nor is paragraph C designed to prevent producers and refiners from favoring company-operated stations over dealers in the allocation of gasoline during periods of shortage. The prevention of misallocation is the clear objective of paragraph F of the Act.

If the goal of the Act was to prevent "a few major oil companies" from securing "monopolistic control" of the market and substantially decreasing competition, J. App. at 19a, that objective can be realized without the drastic measure of divestiture of existing stations. It is inconceivable that 21 separate producers and refiners could use 209 *existing* stations to secure control of the Maryland market. Moreover, any effort on their part to achieve this result could subject them to criminal and civil liability under statutes which prohibit conspiracies

to restrain trade,[38] and prohibit retail price maintenance, price discrimination and predatory pricing schemes which affect competition.[39] Other federal statutes further prohibit unfair methods of competition and unfair and deceptive acts affecting competition.[40] Each of these regulatory schemes serve the interest in question while permitting producers and refiners to market directly to consumers through company-operated stations.

Nor is divestiture of existing company-operated stations needed to prevent misallocation of gasoline. Misallocation of gasoline in times of shortage is prohibited by paragraph F of the Act and by the Federal Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§ 751 *et seq.*, and the regulations promulgated thereunder, 10 C.F.R. Parts 210-211.[41]

As stated in *Hunt v. Washington Apple Advertising Commission,* 97 S. Ct. 2434 (1977), "[w]hen discrimination against commerce . . . is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives, adequate to preserve

[38] Sherman Antitrust Act, 15 U.S.C. § 1; Maryland Antitrust Act, MD. COM. LAW CODE ANN., § 11-201. The trial court below concluded that "[t]here was no proven detrimental effect upon the retail market caused by company-owned and operated stations which could not be curbed by federal and state anti-trust laws." J. App. at 130a.

[39] 15 U.S.C. §§ 13 *et seq.;* MD. COM. LAW CODE ANN. §§ 11-201 *et seq. See also,* Maryland Gasoline Products Marketing Act, MD. COM. LAW ANN. § 11-304(c) and Maryland Unfair Sales Act, MD. COM. LAW CODE ANN. §§ 11-401 *et seq.* which regulate the conduct of retail marketing of gasoline in Maryland.

[40] Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (1975).

[41] The Energy Policy and Conservation Act, Pub. Law No. 94-163 (1975) has extended operation of the Act through September 30, 1981.

the local interests at stake." *Id.* at 2446. Given the discriminative burden of paragraph C upon commerce, the State failed to sustain its burden in justifying that provision. As demonstrated above, paragraph C in no way furthers Maryland's goal of preserving competition. Moreover, existing federal and Maryland laws, far less drastic and discriminatory, clearly address each perceived threat to competition and preserve the local interests at stake.

The avowed purpose of the Maryland Act is the preservation of independent retail dealers. The sole thrust of paragraph C is directed at a single segment of the vertically integrated operations of producers and refiners of petroleum products. Those operations by their very nature stretch across Maryland's borders and implicate commerce. In enacting paragraph C, the State goes far beyond regulation of intrastate affairs and undermines the "national interest in the free flow of goods between the states." *Hunt v. Washington Apple Advertising Commission,* 97 S. Ct. 2434, 2447 (1977).

Paragraph C's immediate benefits are visited upon purely local interests. Its consequences are visited upon an entire class of interstate competitors and upon the motoring public who will be deprived of that class' direct presence in the Maryland market. The impact on commerce is not slight; it is real, substantial and lacks any countervailing local interest which measures up to that burden.

CONCLUSION

For the reasons set forth above, we submit that the final judgment of the Court of Appeals of Maryland should be reversed and that paragraph C of Chapter 854 of the Laws of Maryland, 1974, as amended by Chapter 608 of the Laws of Maryland, 1975 should be declared unconstitutional.

Respectfully submitted,

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